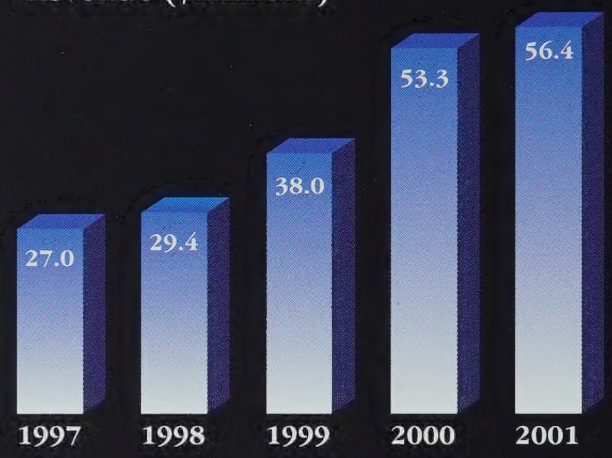
# DALSA is...

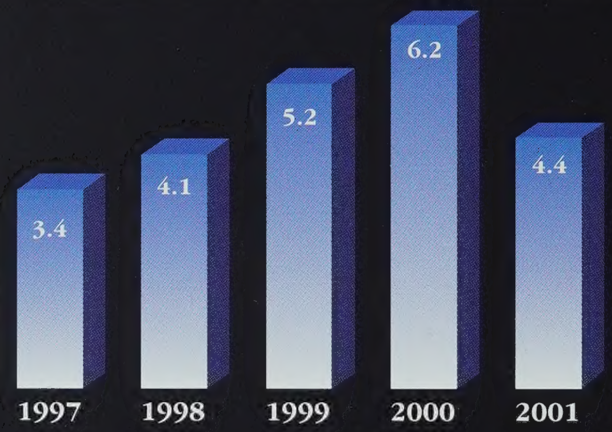
DALSA

technology with vision

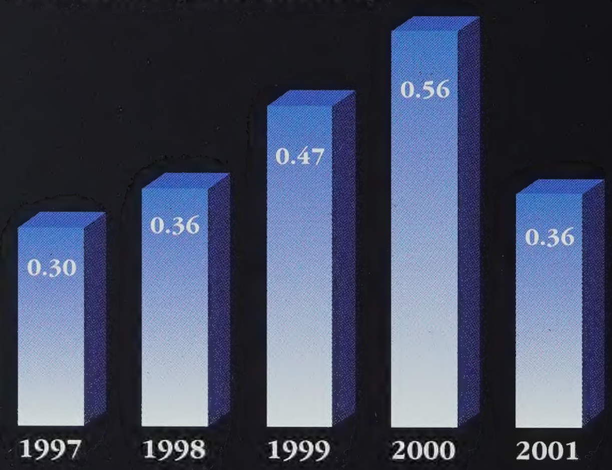
## Revenue ($Millions)




## Earnings from Operations ($Millions)[1]




## Earnings from Operations Per Share (Cdn Dollars)[1]




[1] Excludes amortization of intangible assets

DALSA is an international leader in digital imaging solutions, designing, developing, manufacturing and marketing high performance image sensors, electronic digital cameras and vision systems. Geographic areas of operation include Canada, the United States, Europe, and Asia Pacific. Based in Waterloo, Canada, with operations in Colorado Springs, Tucson, Munich, and Tokyo, DALSA is a public company listed on the Toronto Stock Exchange under the symbol "DSA".

## 2001 Achievements

- Strong net earnings despite difficult economic conditions
- Healthy cash generation positions company for growth in 2002
- Substantial increase in Life Sciences product sales
- Delivered next generation Piranha2 linescan and DALSTAR areascan digital camera products
- Achieved continued success with custom development contracts in target semiconductor markets

# DALSA is Digital Imaging Solutions

Contents:



DALSA

technology with vision

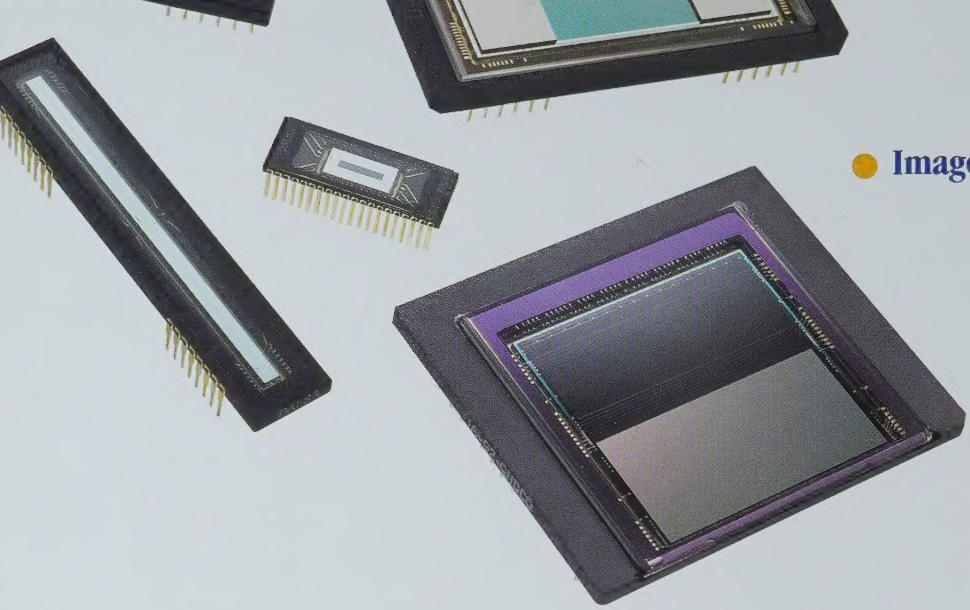


Image Sensor Chips

# We're the eyes of

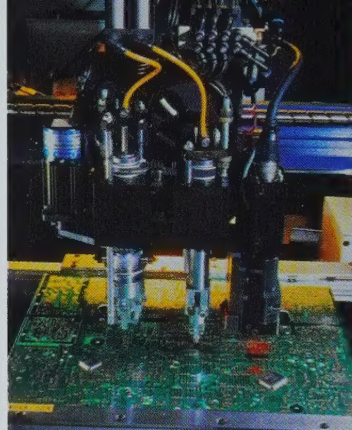
To find out who DALSA is, take a look inside the technology products that enrich our lives — things like cell phones, personal computers, PDAs, and pagers. Inside each of these products you'll find electronic components that need to be manufactured reliably and at the lowest possible cost. That's where DALSA adds value. Our sensors and cameras visually inspect silicon wafers, semiconductor chips, electronics and LCD flat panels at various stages of their production to make sure the components are free of defects and meet stringent quality control standards. As the world demands more reliable and less expensive technology the market opportunity for DALSA increases.

At the same time, we're improving the world around us by delivering innovative imaging products that make our lives healthier. Our camera for digital mammography, for example, provides a less intrusive procedure for breast biopsy and reduced x-ray levels for the patient. By replacing x-ray film with digital imaging, DALSA products improve throughput and efficiency at hospitals and clinics while minimizing patient discomfort. We know if we succeed as a company, the world will be a better place.

**Complete Vision Solutions**

# the vision system

**Electronic Digital Cameras**

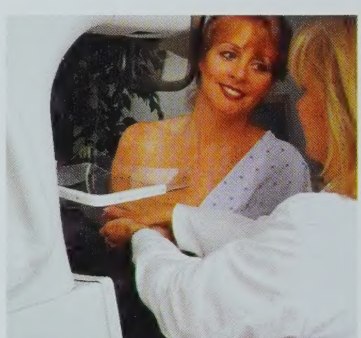



Semiconductor & Electronics Inspection

# We're known for the company we keep

DALSA is a global company. Our customers, Original Equipment Manufacturers (OEMs) in the Semiconductor and Electronics and Medical industries, are world-wide leaders in their respective fields. We help them succeed by providing a range of camera and sensor products that improve their assembly and inspection processes which allows them to maintain leadership in their industries.

The faster and more reliably our customers can inspect their products in-process, the higher their throughput and the lower their costs. Every advance in performance in a DALSA sensor or camera means another opportunity for our customers to add value. That's been our formula for success for over 20 years.

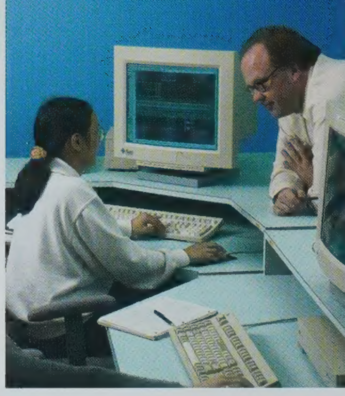


Medical Imaging

CB TECH 100

*Canadian Business Magazine*
*Top Tech 100 for 2001*

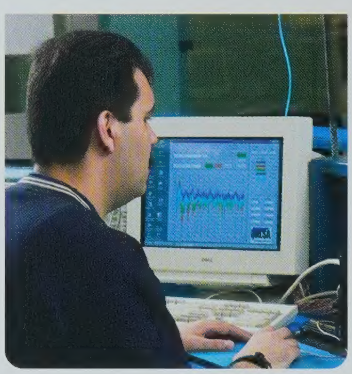

NCR
Dolby



# We're passionate

At DALSA we realize that our people and our technology are our two most valuable assets. The talents, drive, and knowledge of our employees are an important competitive advantage. Our culture of innovation extends from our research and development initiatives through our manufacturing processes. The positive working environment created by all of the employees at DALSA received national recognition in the 2002 edition of "Canada's Top 100 Employers".

Backed by our core knowledge and track record for innovation, we have and continue to develop a versatile range of solutions that meet the most demanding imaging applications. We strive to maintain our leading edge in technology development in our traditional markets as well as invest in research into new applications where our technology will succeed.



Canada's Top
100
Employers
2002

www.CanadasTop100.com

# about innovation

**EXCELLENCE**
We have only one quality standard – excellence.

**TEAM WORK**
We are all on one team with a shared vision.

**CUSTOMERS**
We create superior value for our customers.

# . . . and we're here

## We seek excellence by:

Building an environment of growth where dedicated people work together.

Creating innovative technology, quality products, and superior imaging solutions.

Succeeding with our customers in new and current markets.

**COMMITMENT**
We do what we say we will do.

**INNOVATION**
We embrace change and reward innovation.

**PEOPLE AND TECHNOLOGY**
Our associates and our technology are our strength.

CANADA'S TOP 100 CORPORATE R&D SPENDERS
RE$EARCH Infosource Inc.

## Our core values:

We exist to create more and ever better technology.

We are open, direct and thorough.

DALSA exists for the long term.

We strive to do even better tomorrow.

We treat employees and customers with integrity.

# for the long term

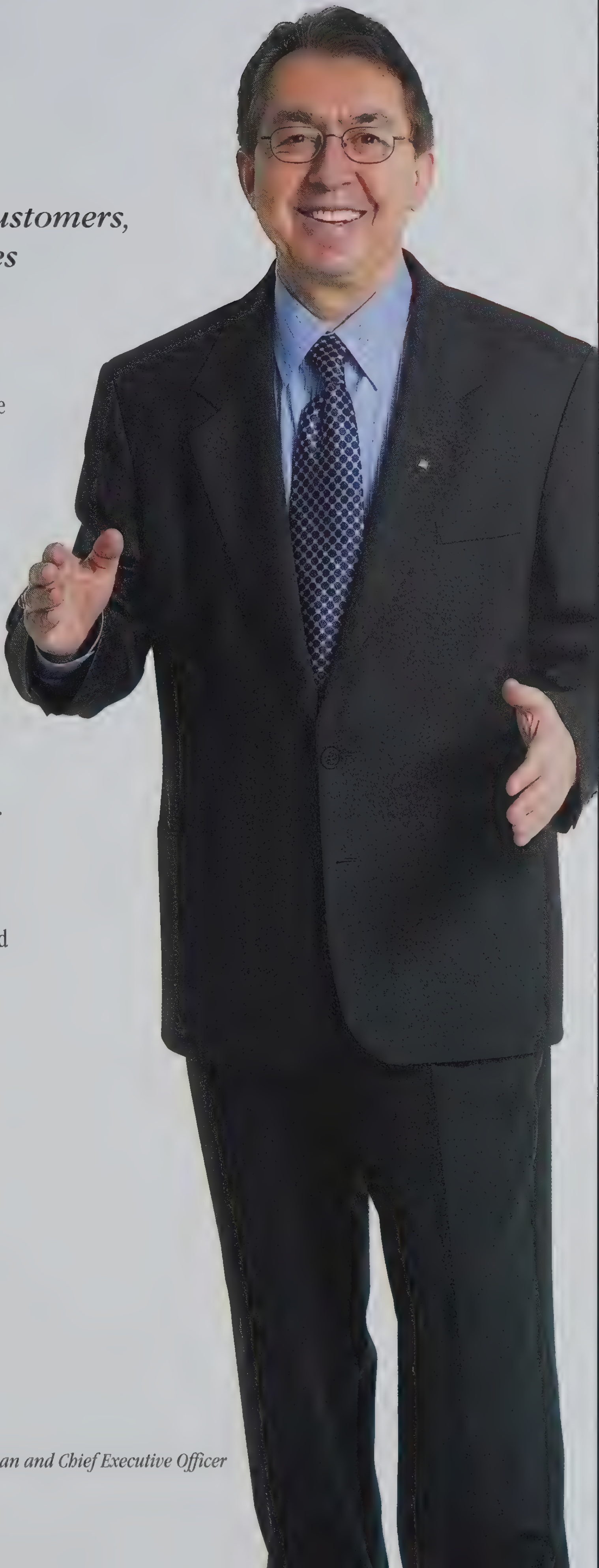
# That's who we are.

DALSA

technology with vision

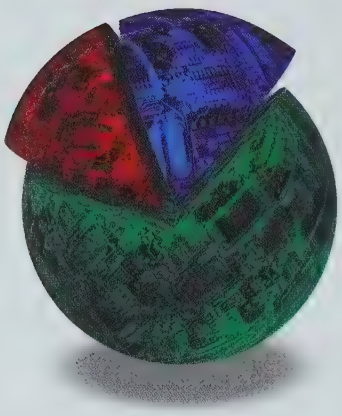
# Chairman's Report

## *To our shareholders, customers, partners and employees*



Despite a weak overall economic climate this past year, DALSA has delivered strong performance. The year 2001 started with the downturn of the information technology infrastructure industry and the collapse of the dot coms. This was followed by the economic downturn of the semiconductor and electronics market segments. Subsequently we had the tragic terrorist attacks leading to the war on terrorism. Overall we had a world-wide economic downturn and an unpleasant year. The semiconductor and electronics downturn also hit DALSA. Pre-downturn this market segment represented approximately 50% of our revenue. We saw our revenue from this segment drop to 35-40% of total revenues during the last year.

***Dr. Savvas Chamberlain**, Chairman and Chief Executive Officer*



**Revenue Breakdown by Geographic Region**

- North America 68%
- Europe/Middle East 19%
- Asia/Pacific 13%

Deterioration in the semiconductor and electronics marketplace was much worse for many of DALSA's competitors. DALSA's technology leadership strengthened our market share, providing some offset to this cyclical downturn, limiting the downward impact for DALSA in this particularly hard hit sector. Growth in other markets also helped overcome this short-term weakness. Furthermore, the Strategy for Growth which we put into place in the latter part of 2000 accompanied by the management re-organization into Strategic Business Divisions helped the company to overcome the general economic downturn. Many other companies in our field saw their total revenue drop as much as 50%, and in some cases leading to significant losses and huge layoffs. DALSA, because of its Strategy for Growth and its strong management, succeeded in managing its operations in a more challenging environment. We achieved 6% total revenue growth in 2001 relative to the previous year. The net earnings were also good — 4 million dollars, and without layoffs. Further, our cash situation was also healthy, DALSA moved out of the year with 9 million dollars of cash. During the year, we generated 6 million dollars of cash before repayment of bank debt that was incurred last year. At year end, we have no short-term debt and only a small amount of long-term debt related to our past acquisitions. For all this success the credit of course goes to our executives, managers and all the employees of DALSA which I am proud to acknowledge.

In 2001 we continued to nurture our corporate competitive strategy. This strategy has been used since 1985 when we first capitalized DALSA. This strategy uses technology as the competitive engine of the corporation. We invest in the development of new technology continuously, our research and development spending is at about 20% per annum relative to sales. The breadth and depth of our R&D capabilities means that DALSA can span the gamut from fundamental research through breakthrough product development. Our R&D capacity and experience allows us to generate these advances internally, as well as effectively assimilate, refine, extend and commercialize technologies that we bring in through acquisition or partnership. We target market segments which have healthy growth rates and attractive competitive dynamics, identify their needs, and introduce our technology into new products to meet those needs. Newly identified needs help to push new technology developments, and the cycle

continues. We concentrate on introducing products with high value added, with significant value added margin left for our customers. Because of the control of our technology, we are able to introduce products which are unique and ahead of the competition.

The silicon image sensor chips we design and manufacture (see level 1 of the pyramid diagram at the right) are strategic to our company . We incorporate the image sensors into modules and cameras (level 2). Original Equipment Manufacturers (OEMs, level 3) buy our modules, cameras, and sensors to produce vision systems used in manufacturing operations (level 4). The vision systems identify objects, inspect them and aid in automating the manufacturing process, thereby improving industrial efficiency through enhanced flexibility, quality, repeatability and cycle times. Our cameras, modules and image sensor chips serve as the "electronic eyes" of these machines. The end-products (level 5) that are produced by these automated manufacturing facilities and aided by the visions systems include silicon chips used in everyday items such as home appliances, telephones, cars, cell phones, and personal computers.


**DALSA's Vision for Machines Supply Chain**

We continue to target products in high end applications where we use our new technology; however, we also selectively move mature technology to mid performance markets which have demands for higher volume. Strategic market targeting enables us to maintain our traditional product margins with this approach. This strategy enables us to maintain healthy net margins, supporting our business model goal of 10 - 12% earnings after tax. In our field, we are internationally recognized as leaders in products and technology. Our products set the standards in our field and are used in many applications which contribute to the betterment of our lives.

Moving forward we shall continue to maintain our core technology competitive competencies. These include technology in CCD image sensors, CMOS image sensors, mixed signal circuit design, digital camera design and on-time-every-time manufacturing and delivery. My goal is to further extend strategically these technology competitive competencies both through internal research and through acquisitions.

These competitive core competencies are supported by our ISO 9001 internal operations, an internal sales force, a marketing group, and a well maintained international representative and distributor sales network. This network is supported by sales offices in Waterloo, Colorado Springs, Tucson, Munich and the newly established site in Tokyo.

In the past year, we continued to improve the operations of our Life Sciences business unit. We refined operating processes. We improved its new leased premises, we continued improvement of our x-ray cassette digital camera product line, and we introduced a major new x-ray protein crystallography product. Our digital x-ray cameras and x-ray crystallography products are sold to OEMs. The x-ray cassette camera is used in mammography. It fits into the conventional x-ray film housing of the x-ray examination table. OEMs retrofit such existing x-ray examination tables which are found in examination laboratories and hospitals. Looking ahead we plan to extend further the Life Sciences product lines for medical and biotechnology imaging.

Our Life Sciences division is providing technological leadership worldwide in x-ray breast biopsy. The x-ray digital cassette camera cuts down the needle breast biopsy procedure from the conventional 5 - 10 minutes to approximately half a minute. It also improves the quality of the examinations since the patient is less likely to move during such a short examination period with the use of our digital x-ray camera. It also minimizes the discomfort of the patient on the examination table since the breast of the patient is clamped during the examination procedure.

In 2001, we continued looking at and evaluating other companies for potential acquisitions. We also looked at and evaluated divisions of other companies. We shall continue this activity in the new year. We have a mergers and acquisitions group that keeps monitoring the market place and brings assets for evaluation. The criteria we use include the acquisition of new or complimentary technology, new market segments, good return on investment, fit with the DALSA culture and preferably earnings per share accretive within a year but not later than two years.

**Our New Offices In Japan**

In September, we opened our new dedicated DALSA facilities within Tokyo for Sales and Technical Customer Support. This office will shorten communication lines, and deepen relationships with major accounts and prospects in Asia.

We are confident that we can successfully integrate acquired assets. We have depth in our executive management team, our present corporate strategic business unit structure allows management focus, and with our previous experience in acquisitions, we can succeed in integrating new assets into the DALSA corporate system.

We can finance acquisitions through our credit facility which we have already in place. Then, when the capital markets improve, we can raise equity financing. By following this strategy we can achieve two goals - retire the debt and increase stock liquidity.

Moving forward I see a great future for DALSA Corporation. My goal is to achieve a total sales revenue of $100 million[1] with profitability. This would more efficiently utilize our general and administrative infrastructure, make the company self-contained and robust, increase the depth in its core competitive technologies, make DALSA more competitive, increase stock liquidity, and finally return the corporation to its traditional 10 - 12% per annum earnings after tax relative to sales. The latter should give a healthy return on investment for our shareholders.

In closing I would like to thank all the DALSA employees for their continued excellent performance. I also want to acknowledge and thank our customers, our sales representatives and distributors, our shareholders, the investment houses and analysts who supported and continue to support our corporation.

Sincerely,

Savvas Chamberlain
CEO and Chair of the Board of Directors
DALSA Corporation

*[1] As of the end of January, 2002, DALSA announced two acquisitions, the Zarlink Semiconductor Wafer Foundry at Bromont, Quebec and the Philips CCD Business Unit in the Netherlands. DALSA's annualized total revenue is expected to exceed $100 million following these acquisitions.*

# President's Message

## *A Report on Operational Achievements for 2001*

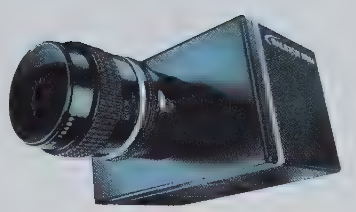
As DALSA's President, I am pleased to report on some of the operational achievements of our company in 2001, and to provide a brief outlook for 2002. One year ago I described our plans to operationalize our Strategy for Growth. Progress on our efforts continues, despite the challenges faced by our team as a result of the slowdown in the world economy. We will continue to move forward with our Strategy for Growth as the economy recovers in 2002.

***Brian Doody**, President*

Success in our traditional business in our Vision for Machines unit continued in 2001, although the impact of the downturn in the semiconductor industry was notable. Prior to the downturn, 50% to 60% of sales in this unit were to Original Equipment Manufacturers providing high performance inspection equipment to electronics and semiconductor production lines. 2001 saw a significant drop in demand for semiconductors and electronics capital equipment in general. This industry is cyclical in nature, with the 2001 downturn one of several experienced over the last 20 years. Despite last year's position in the cycle, new equipment sales did continue in 2001, as did DALSA's sale of digital imaging solutions to this market.

Historically, downturns in this industry have been a key period for OEMs to develop new products. Those companies, DALSA's customers, know that an upturn will take place, and they all strive to have the newest and highest performance equipment available to take the market lead when their customers begin to buy once again. DALSA therefore expects to be in an excellent position to participate in this upturn, owing to our development relationships with the leading semiconductor equipment manufacturers. We continue to develop our imaging technology for this market, and look to achieve design-in wins in next generation products. These products will be the basis of new capital equipment buys as the market recovers.

Other portions of our Vision for Machines group continued to show strength in 2001. New products formed the basis for some of that strength. In January 2001, DALSA announced the release of Piranha2, a small-footprint, very high speed digital line scan camera. These sleek-sized cameras are ideal for PCB inspection, multi-camera vision applications and other demanding applications including parcel and postal sorting.



**New Products**

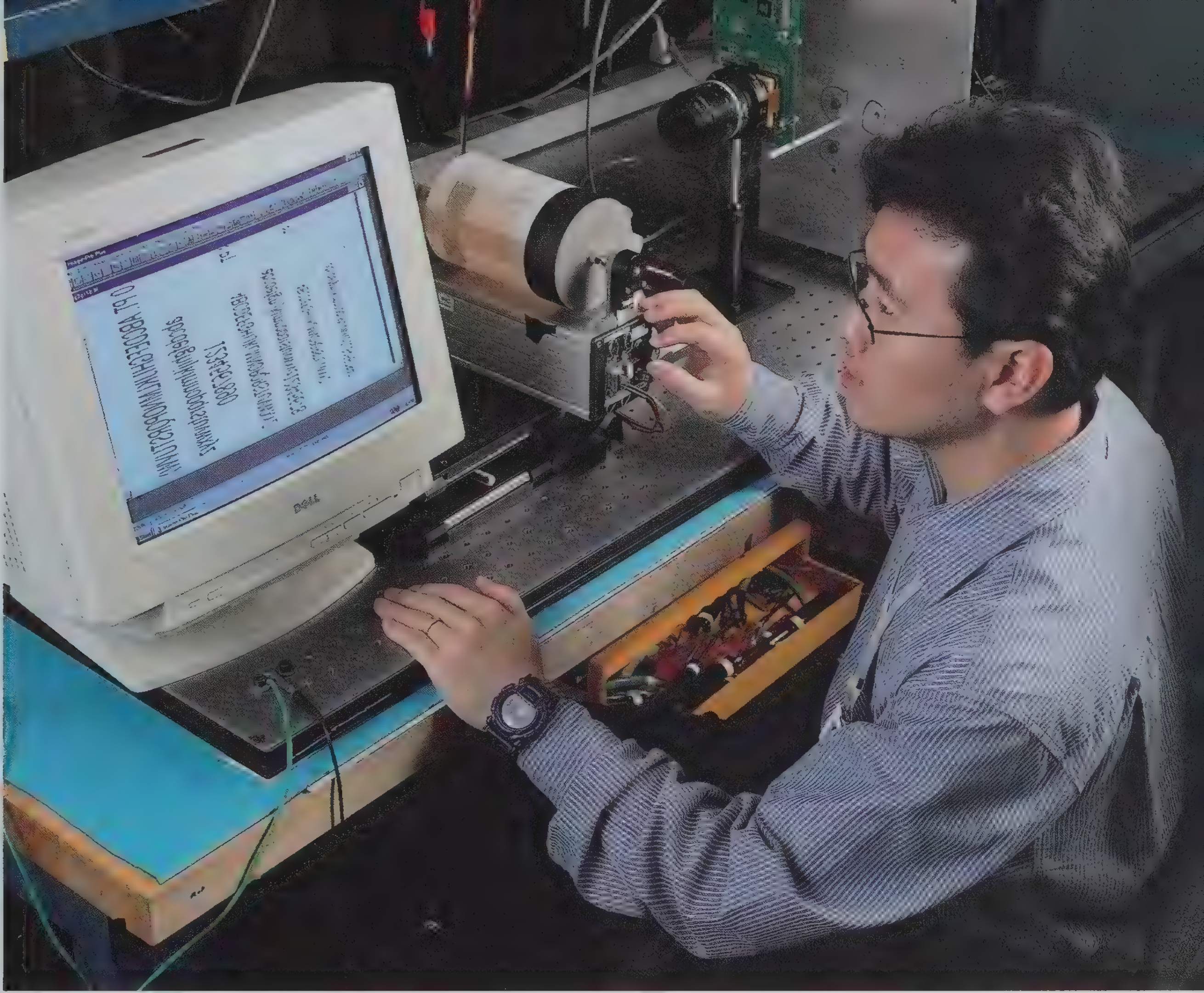
In 2001, our Vision for Machines group successfully launched the latest generation Piranha2 linescan cameras and two new DALSTAR area cameras, the 4M30 and 6M18.

New areascan digital camera products were also launched in 2001. The 4M30 digital camera is designed for fast, very high resolution imaging. DALSA marked another first with this product, offering the first area scan camera to combine 4 million pixel resolution and true 12-bit digital output at 30 frames per second. The 4M30 is just one of the new DALSTAR line of cameras introduced last year. This line is now the most complete line of mega and multi-mega pixel, high speed, high dynamic range area scan cameras in the world. These cameras are suitable for advanced industrial applications such as bare-board electronics inspection, as well as more diverse areas such as professional digital photography.

"Our successes in 2001, and our positive outlook for 2002, could not be possible without the great team of people we have assembled in our company worldwide."

The diversification of our Strategy for Growth helped to decrease the impact of 2001's economic picture: as revenue growth slowed in our Vision for Machine group, the revenue from our Life Sciences digital imaging products more than compensated. Our digital mammography products and our cameras used within the protein crystallography field were both delivered in numbers more than double that achieved in 2000.

Delivery to DALSA's long term Vision Systems customer, DuPont, continued in 2001. Late in the year our most complex high performance film inspection system to date was accepted by this customer for use in one of their new production lines. Although the curtailment of capital spending in all industries hurt the growth of Vision Systems in 2001, our expectation is that numerous opportunities will come to fruition in 2002.



Our excellent technical progress last year in our Digital Cinema group promises to lead to a strong position for DALSA in the image capture end of the emerging digital cinema infrastructure. Within the industry, much development and deployment has taken place in digital exhibition. Now, as DALSA makes high speed film digitizing feasible, and even permits the elimination of film through film-quality digital imaging, a completely digital process in the movie industry will become viable.

An exciting event in 2001 was the successful launch of DALSA's first cameras in space, as the Space Shuttle Endeavour lifted in April off with our world-class camera technology on board. Our cameras, developed over a period of several years for this epitome of challenging applications, provide the "electronic eyes" for the Canadarm2. Just as our cameras are used on earth in production lines, our space-bound digital imaging solutions permit accurate and automated assembly tasks; in this case, for the International Space Station.

Certainly, our successes in 2001, and our positive outlook for 2002, could not have been possible without the great team of people we have assembled in our company worldwide. Our 300+ employees are located internationally in Waterloo, Canada; Tucson and Colorado Springs, USA; Munich, Germany; and Tokyo, Japan. As you'll see elsewhere in this report, I am very pleased that DALSA was recognized as one of Canada's Top 100 Employers in 2001; an honour that translates to a committed, dedicated workforce who will help our company to continue to grow. DALSA also garnered industry recognition within Canadian Business Magazine's Tech 100 listing (a listing of Canada's largest and best-performing public technology companies compiled by Andersen and Canadian Business magazine using publicly-available information).

Our whole team, worldwide, anticipates a busy and exciting 2002. Revenue growth is expected in all our units as our markets rebound, and we are focussing our operations on a return to our traditional long-term profitability model of 10%-12% net earnings after tax. Continued expansion in our Life Sciences business and the expected cyclical recovery of the Semiconductor and Electronics Manufacturing Capital Equipment business will aid in our own success in 2002.

2001 was a challenging year for DALSA, one in which we kept the company strong and retained our solid fundamentals. I look forward to our expanding opportunities in 2002, and to reporting upon our expected successes as they occur throughout the year.

Sincerely,

Brian C. Doody
President,
DALSA Corporation

**DALSA's Board of Directors 2001**

(Clockwise from bottom left):

David Linton, Gene Weckler,

John Simons, Brian Doody,

Don Lenz, Ian McPhee,

Graham Jullien, Savvas Chamberlain

# Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of the Company's consolidated results of operations and financial condition. This discussion should be read in conjunction with the Consolidated Financial Statements and accompanying notes. Certain statements contained in the following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements, relating to the operations or to the environment in which we operate, which are based on our operations, forecasts and projections. Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions and the Company's actual results may differ materially from those anticipated in these forward-looking statements.

## Overview

DALSA is an international digital imaging solutions company employing close to 300 skilled people. The Company is headquartered in Waterloo, Ontario, Canada, with additional operations in Tucson, Arizona, USA and Colorado Springs, Colorado, USA. The Company has sales offices in Munich, Germany and Tokyo, Japan. DALSA products are sold worldwide to over 1,200 customers in over 25 countries through an extensive global distribution network.

With the acquisitions of DALSA Colorado Springs Inc., formerly Silicon Mountain Design Inc., in 1999 and DALSA MedOptics, at the beginning of 2000, the Company has been able to expand its accessible markets rapidly. These two acquisitions have also allowed the Company to diversify its target markets, reducing its vulnerability to cyclical trends in any one industry. The Company was able to compensate for a reduction in revenues in the semiconductor and electronics market in 2001 with a significant growth in its Life Science product and application specific contract revenues. The Company delivered on plans for improved manufacturability and throughput of its Life Sciences products in 2001, resulting in the division being able to meet much of the demand for its products. Prospects for the Life Sciences division remain excellent into 2002. The Company also anticipates a gradual recovery of its most significant market, the semiconductor and electronics market, during 2002. DALSA is technologically and financially positioned to take advantage of the recovery.

As a result of the Company's commitment to research and development and the integration of that technology into products, the Company released the Piranha 2 in 2001, the world's fastest, most responsive line scan camera. The Company also announced in 2001 that the Canadarm 2, to be used for assembly and repairs of the International Space Station, is using DALSA's cameras and video processing electronics located on the arm.

Historically, the Company's operating results have fluctuated on a quarterly basis and the Company expects that quarterly financial results will continue to fluctuate in the future. Fluctuations in results relate to the timing of standard product sales to OEM customers, which may place large single orders in any one quarter, and to the timing of staffing and infrastructure additions to support growth.

## Supplementary Measure of Net Earnings

As a measure to assess financial performance, management utilizes a supplementary measure of net earnings and net earnings per share which excludes the impact of acquisition related costs. Management believes that most of its shareholders, creditors, other stakeholders and analysts prefer to analyze the Company's results based on this performance measure. However, net earnings as adjusted for these items do not have any standardized meaning prescribed by generally accepted accounting principles and are therefore unlikely to be comparable to similar measures presented by other issuers.

The supplementary measure of net earnings and supplementary measure of basic and fully diluted earnings per share have been calculated and presented in a manner consistent with prior years.

The supplementary measure of earnings and earnings per share is as follows:

| In thousands [except per share data] | 2001 $ | 2000 $ |
|---|---|---|
| Net income (loss) | 3,986 | (11,097) |
| Amortization of intangible assets, net of related tax | 371 | 17,317 |
| Supplementary measure of net earnings | 4,357 | 6,220 |
| Supplementary measure of basic earnings per share | 0.36 | 0.56 |
| Supplementary measure of fully diluted earnings per share | 0.36 | 0.56 |

## Results of Operations

*Year Ended December 31, 2001 Compared to Year Ended December 31, 2000*

## Overview

The following table sets forth the percentage of standard product revenue represented by certain items in the Company's consolidated financial statements of the Company for the above noted periods.

| | 2001 | 2000 |
|---|---|---|
| Standard product revenue | 100% | 100% |
| Cost of sales | 50% | 47.1% |
| Gross margin | 50% | 52.9% |
| Expenses | | |
| Selling, general & administration | 29.6% | 26.1% |
| Research and development, net[1] | 6.1% | 6.7% |
| Foreign exchange | (1.1%) | (0.3%) |
| Income before under-noted | 15.4% | 20.4% |
| Interest expense (income) | (0.1%) | 0.6% |
| Earnings before income tax and amortization | 15.5% | 19.8% |
| Income taxes | 6.3% | 5.8% |
| **Supplementary Measure of Net Earnings** | **9.2%** | **14.0%** |
| Amortization, net of income tax | 0.8% | 38.9% |
| Net Earnings | 8.4% | (24.9%) |

Note:

[1] Net research and development costs are comprised of total research and development costs less the aggregate of investment tax credits and ASC revenues.

| | 2001 | 2000 |
|---|---|---|
| Research and development costs | 28.9% | 29.6% |
| Investment tax credits | (3.1%) | (2.9%) |
| Government grants | (0.1%) | (0.2%) |
| ASC revenue | (19.6%) | (19.8%) |
| Research and development costs, net | 6.1% | 6.7% |

## Revenues

The Company's revenues are comprised of:

| | 2001 ($000's) | 2000 ($000's) | Increase ($000's) 2001 v. 2000 | Percentage Increase 2001 v. 2000 |
|---|---|---|---|---|
| Standard Products | $47,200 | $44,506 | $2,694 | 6.1% |
| Application Specific Contracts | 9,235 | 8,815 | 420 | 4.8% |
| | $56,435 | $53,321 | $3,114 | 5.8% |

All revenue growth in 2001 over 2000 was organic growth as all acquisitions were completed by the start of 2000.

Standard product revenues in the semiconductor and electronics market saw a decline in 2001 from 2000. The decline was offset by strong results in the postal and document markets and from the Company's Life Sciences products.

Standard product revenue increased in each of the Company's geographic regions as detailed in the table below. Growth in North America was largely due to revenue from the Life Sciences division. The increase in European and Asian revenues reflects growth in the major European and Asian countries in which the Company operates.

| | 2001 | 2000 | Increase ($000's) 2001 v. 2000 | Percentage Increase 2001 v. 2000 |
|---|---|---|---|---|
| North America | $30,032 | $29,048 | $984 | 3.4% |
| Europe | 10,493 | 9,177 | 1,316 | 14.3% |
| Asia | 6,675 | 6,281 | 394 | 6.3% |
| | $47,200 | $44,506 | $2,694 | 6.1% |

Application specific contract revenue also had a moderate increase in the current period despite the difficult economic conditions in 2001. DALSA's Life Sciences division contributed $1.2 million to ASC revenues in 2001 versus no ASC revenues in 2000.

## Gross Margin

Gross margin for 2001 was $23.6 million or 50.0% of standard product revenue, compared to $23.6 million or 52.9% in 2000. The Company realized significant improvements in gross margins at its Life Sciences division in 2001 with planned improvements in product design and manufacturability but was hampered by reduced sales in the semiconductor and electronics market segment. The Life Sciences division had a correspondingly heavier weighting in the 2001 consolidated results, reducing the overall gross margin. With the expected recovery in the North American economy beginning in 2002 and with continued improvements in the Life Sciences division, the Company anticipates improvements in gross margins going forward.

## Selling, General and Administrative Expense

Selling, general and administrative ("SG&A") were $13.9 million for 2001, compared to $11.6 million in the prior year. The increase of $2.3 million, or 20.2%, was the result of implementing the Company's strategy for growth in 2001 and the corresponding build of the SG&A infrastructure. As a result of the economic slowdown in 2001, management curtailed the planned growth in SG&A and reduced costs in the latter part of the year.

## Research and Development

DALSA is committed to investing in research and development ("R&D") and targets R&D spending to be approximately 20% of total revenue in a given year. This level of R&D expenditures has proven to be a successful formula for the Company as it allows adequate resources to be invested in improving functionality and performance of its products and developing new technology. This investment results in increased future standard product revenues as the technological advances are commercialized, while at the same time maintaining fiscal responsibility. R&D expenses for 2001 are 21.5% of revenues as compared to 22.2% in 2000.

Gross R&D expenses before deducting ITCs and government grants was $13.6 million, or 28.9% of standard product revenue as compared to $13.2 million or 29.6% of standard product revenue in 2000. ITCs and government grant funding was $1.5 million compared to $1.4 million in 2000. R&D expenditures for 2001 were planned to be higher in keeping with the Company's commitment to its Strategy for Growth. However, with the economic slowdown in 2001, the Company evaluated R&D programs throughout the year and reduced expenses where necessary.

The Company utilizes its ASC revenues as a mechanism to partially fund its research and development activities. In the event that ASC revenue was not available or was significantly reduced, the Company's relative cost of research and development would increase and the Company could be required to consider the postponement or cancellation of certain research and development projects.

## Interest

The Company had interest income for the year of $0.04 million compared to interest expense of $0.3 million in 2000. The Company paid off its bank advance of $5.3 million from 2000 early in 2001, resulting in the improvement in interest costs in 2001.

## Income Tax

The Company's effective tax rate in 2001 was 40.6% as compared to 29.4% in 2000, before non-deductible amortization of intangible assets. The higher effective tax rate in 2001 is the result of higher foreign tax rates relative to Canada and non-deductible foreign exchange losses.

## Liquidity and Capital Resources

For the year ended December 31, 2001, net cash provided by operating activities was a very strong $9.3 million compared to cash used in operating activities of $0.1 million in 2000. The Company focused on improving its working capital position in the current year, resulting in an improvement in operating assets and liabilities of $2.8 million as compared to cash invested in operating assets and liabilities of $8.9 million in 2000. Significant improvements in the year were from a decrease in accounts receivable of $2.3 million and an increase in accounts payable of $0.9 million, offset by an inventory increase of $0.9 million.

In 2001, the Company invested $2.9 million in capital equipment ($2.4 million - 2000) and repaid its bank indebtedness of $5.3 million.

The Company annually accrues amounts required to meet its obligations under its profit sharing and incentive plans and DIPP royalty payment (note 12 of the consolidated financial statements of the Company). These amounts are paid out in the first half of the subsequent year. Accounts payable at the end of the fiscal year reflect accruals for these obligations. The Company has a $10.0 million operating credit facility, a $2.0 million facility to finance capital expenditures and a US$15.0 million acquisition facility. The acquisition facility has a one year term and is extendable annually for an additional year. Under these facilities, the Company is required to maintain certain financial ratios. No amounts were outstanding under the credit facilities as at the year-end.

DALSA believes that cash on hand and cash flow from operating activities will be sufficient to fund currently anticipated working capital, planned capital spending and debt service requirements for the next twelve months. The Company's planned capital spending for 2001 is approximately $3.3 million. In addition, DALSA regularly reviews acquisition opportunities and may therefore require additional debt or equity financing.

## Business Risks and Prospects

The Company anticipates a recovery in the semiconductor and electronics market starting in 2002. There can be no assurance that this recovery will occur in the time anticipated or to the extent of the recovery when it occurs. The timing and extent of the economic recovery could have a material adverse effect on the Company's business, operations and prospects .

The Company relies on third party suppliers for semiconductor wafers, electronic components and other raw materials used in the Company's products. Although the Company seeks to reduce exposure to single source suppliers through inventory maintenance either at DALSA or with suppliers, loss of certain of these suppliers, or the inability of certain of these suppliers to deliver to the Company on a timely basis, could have a material adverse affect on the Company's business operations and prospects. In particular, the Company has in the past experienced manufacturing delays due to delays in supply of semiconductor wafers or to defective wafers and there can be no assurance that significant manufacturing delays will not occur in the future.

The Company's future operating results will depend upon its ability to improve and market existing products and to develop and successfully market new products. There is no assurance that the Company will be able to enhance its existing products or to develop new products in response to customer requirements or product introductions by competitors, which could have a material adverse effect on the Company's business, operations and prospects.

The Company has targeted digital cinema as a new market for its digital image capture technology. There can be no assurance that this market will develop and, given the Company's limited experience and operating history in this market, that the Company's investment and efforts in this market will be successful. Failure to succeed in the digital cinema market may adversely affect the Company's future business, financial condition and operating results.

As the Company realizes a significant portion of its revenue in United States dollars and incurs expenses in Canadian dollars, increases in the value of the Canadian dollar relative to the United States dollar could adversely affect the Company's operating results. The Company has previously entered into forward exchange agreements in respect of certain transactions to hedge its foreign exchange exposure. The Company will evaluate its foreign exchange exposure and may enter into forward exchange agreements in the future, if appropriate in the circumstances.■

## To Our Shareholders

The accompanying consolidated financial statements are the responsibility of Management and have been approved by the Board of Directors of the Company. Management is responsible for and has prepared and presented the consolidated financial statements in accordance with accounting principles generally accepted in Canada and has made any significant accounting judgements and estimates required. Management has ensured that financial information contained elsewhere in this Annual Report is consistent with the consolidated financial statements.

Management has developed and maintains systems of internal controls designed to provide reasonable assurance that reliable and relevant financial information is produced. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable financial statements.

The Board of Directors is responsible for reviewing and approving the consolidated financial statements and ensuring management meets their financial reporting responsibilities.

The Audit Committee consists solely of directors who are not officers of the Company and reviews with Management and the external auditors the annual consolidated financial statements of the Company prior to submission to the Board of Directors for final approval. The Audit Committee also meets during the year with Management and the external auditors to discuss internal control issues, auditing matters, and financial reporting issues. External auditors have free access to the Audit Committee without obtaining prior Management approval.

The Shareholders have appointed Ernst and Young LLP as the external auditors of the Company and, in that capacity, they have examined the consolidated financial statements for the years ended December 31, 2001 and 2000. The Auditor's report to the Shareholders' is presented herein.

On behalf of the Board:

Director
Savvas G. Chamberlain, M.Sc., Ph.D.,FIEE
Chairman and Chief Executive Officer
DALSA Corporation

Director
J. David Linton, B.A.,LL.B.
Partner
White, Duncan, Ostner & Linton

## To the Shareholders of DALSA Corporation

We have audited the consolidated balance sheets of DALSA Corporation as at December 31, 2001 and 2000 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Kitchener, Canada,
January 16, 2002

# Consolidated Balance Sheets

## DALSA Corporation

(Incorporated under the laws of Ontario)

As at December 31

| In thousands | 2001<br>$ | 2000<br>$ |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash and cash equivalents | **9,256** | 8,603 |
| Accounts receivable | **9,230** | 11,550 |
| Accrued revenue | **1,849** | 1,662 |
| Inventory *[note 6]* | **13,719** | 12,815 |
| Prepaid expenses | **872** | 565 |
| **Total current assets** | **34,926** | 35,195 |
| Long-term investment *[note 8]* | **714** | 411 |
| Property and equipment *[note 7]* | **9,710** | 9,411 |
| Deferred income taxes *[note 10]* | **1,997** | 1,381 |
| **Total assets** | 47,347 | 46,398 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current** | | |
| Bank indebtedness *[note 9]* | - | 5,323 |
| Accounts payable and accrued liabilities | **9,431** | 8,486 |
| Income taxes payable *[note 10]* | **3,040** | 1,607 |
| Deferred revenue | **431** | 976 |
| Long-term debt due within one year *[note 9]* | **956** | 675 |
| **Total current liabilities** | **13,858** | 17,067 |
| Long-term debt *[note 9]* | **1,571** | 1,629 |
| **Shareholders' equity** | | |
| Share capital *[note 11]* | **26,921** | 26,691 |
| Retained earnings | **4,997** | 1,011 |
| **Total shareholders' equity** | **31,918** | 27,702 |
| **Total liabilities and shareholders' equity** | 47,347 | 46,398 |

*See accompanying notes*

# Consolidated Statements of Operations and Retained Earnings

## DALSA Corporation

Year ended December 31

| In thousands | 2001<br>$ | 2000<br>$ |
|---|---|---|
| **REVENUE** | | |
| Standard product sales | **47,200** | 44,506 |
| Application specific contracts | **9,235** | 8,815 |
| **Total revenue** | **56,435** | 53,321 |
| **EXPENSES** | | |
| Cost of product sales | **23,585** | 20,955 |
| Research and development, net *[note 12]* | **12,126** | 11,826 |
| Selling, general and administrative | **13,950** | 11,608 |
| Amortization of intangibles *[note 4]* | **611** | 24,922 |
| Foreign exchange | **(513)** | (143) |
| | **49,759** | 69,168 |
| Income (loss) before undernoted | **6,676** | (15,847) |
| Interest (income) expense, net | **(35)** | 262 |
| Income (loss) before provision for (recovery of) income taxes | **6,711** | (16,109) |
| Income taxes provision (recovery) *[note 10]* | **2,725** | (5,012) |
| **Net income (loss)** | **3,986** | (11,097) |
| Retained earnings, beginning of year | **1,011** | 12,108 |
| **Retained earnings, end of year** | **4,997** | 1,011 |
| **Earnings (loss) per share** *[note 3]* | | |
| Basic | **0.33** | (1.01) |
| Fully diluted | **0.33** | (1.01) |
| Weighted average number of shares outstanding [in thousands] | **12,056** | 11,017 |

*See accompanying notes*

# Consolidated Statements of Cash Flows

## DALSA Corporation

Year ended December 31

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income (loss) | **3,986** | (11,097) |
| Add (deduct) non-cash items: | | |
| Depreciation | **2,566** | 2,601 |
| Amortization of intangibles | **611** | 24,922 |
| Deferred income taxes | **(616)** | (7,573) |
| Changes in operating assets and liabilities | **2,793** | (8,918) |
| **Cash provided by (applied to) operating activities** | **9,340** | (65) |
| **INVESTING ACTIVITIES** | | |
| Acquisition | **(611)** | (5,064) |
| (Increase) in long-term investment | **(303)** | (266) |
| Property and equipment additions | **(2,865)** | (2,386) |
| Cash (applied to) investing activities | **(3,779)** | (7,716) |
| **FINANCING ACTIVITIES** | | |
| (Decrease) increase in bank indebtedness | **(5,323)** | 5,323 |
| Issuance of share capital | **230** | 7,626 |
| Increase (decrease) in long-term debt | **223** | (5,398) |
| (Increase) in employee share loans | **(38)** | (2) |
| **Cash (applied to) provided by financing activities** | **(4,908)** | 7,549 |
| **Net cash provided (applied) during year** | **653** | (232) |
| Cash and cash equivalents, beginning of year | **8,603** | **8,835** |
| **Cash and cash equivalents, end of year** | **9,256** | 8,603 |

*See accompanying notes*

# Notes to Consolidated Financial Statements

## 1. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The following is a summary of the significant accounting policies followed in the preparation of the accompanying financial statements.

### Principles of consolidation

The consolidated financial statements include the accounts of DALSA Corporation and its wholly-owned subsidiaries, hereinafter referred to as the "Company" or "Corporation". Investments in which the Company has a significant influence are accounted for by the equity method.

### Inventory

Inventory is valued at the lower of standard costs, which approximate actual costs, or market [replacement cost for raw materials and work-in-process and net realizable value for finished goods].

### Intangible assets

Intangible assets are amortized on a straight-line basis over their estimated useful lives. Management assesses the impairment of intangible assets by determining whether the unamortized balance can be recovered through undiscounted future cash flows derived from these assets over their remaining useful lives. Any permanent impairment is written off against earnings in the year that such impairment becomes evident.

### Property, equipment and depreciation

Property and equipment are recorded at cost less related government grants and investment tax credits. Depreciation is computed on a straight-line basis as follows:

| | |
|---|---|
| Buildings | 25 to 40 years |
| Equipment | 2 to 10 years |
| Furniture and fixtures | 5 to 7 years |
| Computer software | 2 to 8 years |

### Research and development expenditures

Research and developments costs are charged to earnings in the periods in which they are incurred, except for costs incurred pursuant to specific contracts with third parties, which are charged to earnings in the same period as the related revenue is recognized. Related investment tax credits reduce research and development expense in the same period in which the related expenditures are charged to earnings, provided there is reasonable assurance the benefits will be realized. Developments costs meeting generally accepted accounting principles for deferral are deferred and amortized over their useful lives. The Company has not deferred any such development costs to date.

## 1. Summary of Significant Accounting Policies continued

### Income taxes

The Company uses the liability method of tax allocation in accounting for income taxes. Under this method, deferred tax benefits and obligations are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

### Revenue recognition

Revenue from product sales is recognized at the time goods are shipped to customers. Revenue from long-term application specific contracts, which relate to research and development contracts, is recognized on a percentage completion basis. Under this method, revenue is recognized over the duration of the contract based on costs incurred. The difference between billings and revenue recognized is recorded as deferred or accrued revenue. For contracts where a portion of the payment is based on performance relative to established targets, provision for performance adjustments is included in revenue or cost estimates when amounts can reasonably be determined.

### Foreign currency translation

Foreign currency denominated revenues and expenses are translated at weighted average exchange rates throughout the year. Foreign currency denominated monetary assets and liabilities are translated at rates prevailing at the balance sheet dates. Foreign exchange gains and losses on transactions during the year are reflected in income, except for gains and losses on foreign exchange forward contracts used to hedge specific commitments in foreign currencies. Gains or losses on these contracts are accounted for as a component of the related hedged transaction.

For integrated operations, monetary assets and liabilities are translated at the rates prevailing on the balance sheet date and non-monetary assets and liabilities are translated at historic rates. Revenue and expenses are translated at the weighted average rates throughout the year [other than depreciation and amortization which are translated at the same rates as the related assets]. Translation gains and losses are included in income, except gains or losses on long-term monetary items, which are deferred over the remaining life of the long-term monetary item on a straight-line basis.

### Cash and cash equivalents

Cash and cash equivalents are defined as cash and highly liquid short-term investments.

### Stock-based compensation plans

The Company has stock-based compensation plans as described in note 11. No compensation expense is recognized for these plans when stock or stock options are issued to employees. Any consideration paid by employees on the exercise of stock options or purchase of stock is credited to share capital. If stock or stock options are repurchased from employees, the excess of the consideration paid over the carrying amount of the stock or stock option cancelled is charged to retained earnings.

## 1. Summary of Significant Accounting Policies continued

### Earnings per share

Earnings per share is based on the weighted average number of shares outstanding during the year. Effective January 1, 2001, the Company adopted the revised CICA Handbook section 3500, Earnings Per Share. As a result of adopting this section, the treasury stock method is used to calculate diluted earnings per share. Under the treasury stock method, it is assumed that potential proceeds from the exercise of stock options and warrants would be used to purchase the Company's common shares at the average market price during the period, thereby reducing the number of shares otherwise used to calculate diluted earnings per share. The prior period diluted earnings per share disclosure has been calculated using the treasury stock method.

In May 2000, the Company initiated a two for one stock split. All per share information included in these financial statements has been restated to give retroactive effect to the stock split.

### Use of estimates

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the period. Actual results could differ from those estimates.

## 2. Cash Flows

Cash paid during the year for interest and income taxes was as follows:

| In thousands | **Interest** $ | **Income taxes** $ |
|---|---|---|
| December 31, 2001 | **98** | **1,195** |
| December 31, 2000 | **643** | **1,304** |

## 3. Earnings Per Share

Diluted earnings per share computation

| In thousands | **2001** # | **2000** # |
|---|---|---|
| Weighted average number of shares outstanding | **12,056** | 11,017 |
| Incremental shares from assumed conversion of employee stock options | **14** | 112 |
| Incremental shares from assumed warrant conversion | - | 48 |
| **Adjusted weighted average shares** | **12,070** | 11,177 |

## 4. Acquisitions

### [a] Silicon Mountain Design, Inc.

Effective July 1, 1999, the Corporation acquired all of the shares of Silicon Mountain Design, Inc. ["SMD"], a company engaged in the design and manufacture of high performance digital cameras. The terms of the acquisition provided for additional consideration to the initial purchase price should the acquired business achieve certain revenue levels during the first three years of ownership. This component was treated as contingent consideration to be recorded when determinable. Additional consideration of US $375,000 became payable on June 30, 2000 and was subsequently paid as a result of revenue earned by SMD for the first year of ownership. Furthermore, during December 2000, the Company determined that it would pay the remaining additional consideration in the amount of US$1,536,660, such amount to be repaid over the following five years [see note 9]. These contingent consideration payments were reflected as acquired technology and were amortized in 2000.

### [b] MedOptics Corporation

Effective January 4, 2000, the Corporation acquired all of the shares of MedOptics Corporation, a company engaged in the design and manufacture of high performance digital cameras for medical imaging applications, for cash consideration of US$3,000,000. The acquisition was accounted for using the purchase method. The allocation of the purchase price was to acquired tangible assets net of liabilities assumed - US$300,000 and intangible assets, primarily consisting of acquired technology - US$2,700,000.

The terms of the acquisition provided for additional consideration based on revenue for the calendar year 2001. Such consideration is limited to 20% of the excess of such revenues above US$3,000,000. This component was treated as contingent consideration to be recorded when determinable. During 2001, the Company determined that additional consideration of US$394,400 became payable, such amount to be paid in 2002. This contingent consideration payment was reflected as acquired technology and was amortized in the period.

### [c] Amortization

Accumulated amortization of intangibles arising from the above acquisitions was $33,269,000 and $32,658,000 as at December 31, 2001 and 2000, respectively. The preceding numbers include the impact of deferred taxes on the acquisitions in the amount of $8,843,000.

## 5. Financial Instruments

The Company hedges a portion of its exposure to fluctuations in foreign currencies, generated from future export sales receipts in United States dollars, through the use of options and forward exchange contracts. At December 31, 2001, the Company has outstanding forward contracts with a notional value of US$5,600,000 [US$10,400,000 - 2000] maturing on or before July 31, 2002 at an average exchange rate of $1.5789 [$1.5012 - 2000] and a fair value at December 31, 2001 of $8,919,000 [$15,554,560 - 2000]. The Company limits counterparties to these contracts to Canadian Schedule A Chartered Banks.

The Company invests in a variety of instruments such as certificates of deposit, bankers acceptances and commercial paper. The Company, by policy, limits investments to high quality rated credit, limits the amount of credit exposure to any one financial institution or commercial issuer and limits the term to maturity to less than one year.

The carrying amounts for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair market value because of the short maturity of these instruments. The Company believes that the carrying value of long-term debt approximates fair market value.

The Company sells its products to a diverse range of customers operating throughout the world. Credit limits, ongoing credit evaluation and account monitoring procedures are utilized to minimize risk of loss. The write-off of uncollectable amounts has been insignificant.

The Company has a long-term investment in preferred shares and a convertible debenture [see note 8].

## 6. Inventory

| In thousands | **2001** **$** | 2000 $ |
|---|---|---|
| Raw materials | **9,604** | 9,029 |
| Work-in-process | **710** | 1,313 |
| Finished goods | **3,405** | 2,473 |
| | **13,719** | 12,815 |

Raw materials include $2,696,000 [$2,672,000 - 2000] of wafers and dies which are considered strategic inventory by the Company.

## 7. Property and Equipment

| **2001** In thousands | **Cost** $ | **Accumulated depreciation** $ | **Net book value** $ |
|---|---|---|---|
| Buildings | **5,235** | **1,505** | **3,730** |
| Computer software | **2,908** | **1,617** | **1,291** |
| Equipment | **14,670** | **10,387** | **4,283** |
| Furniture and fixtures | **707** | **506** | **201** |
| | **23,520** | **14,015** | **9,505** |
| Land | **205** | **-** | **205** |
| | **23,725** | **14,015** | **9,710** |

| **2000** In thousands | **Cost** $ | **Accumulated depreciation** $ | **Net book value** $ |
|---|---|---|---|
| Buildings | 5,164 | 1,283 | 3,881 |
| Computer software | 2,631 | 1,237 | 1,394 |
| Equipment | 12,269 | 8,498 | 3,771 |
| Furniture and fixtures | 591 | 431 | 160 |
| | 20,655 | 11,449 | 9,206 |
| Land | 205 | - | 205 |
| | 20,860 | 11,449 | 9,411 |

## 8. Long-Term Investment

| In thousands | **2001** $ | 2000 $ |
|---|---|---|
| **Rad-icon Imaging Corp.** | | |
| Investment in 500,000 preferred shares [2000 - 500,000] | **176** | 224 |
| Convertible debenture | **538** | 187 |
| | **714** | 411 |

## 8. Long-Term Investment continued

During the year ended December 31, 2000, the Company increased its equity investment in Rad-icon Imaging Corp. ["Rad-icon"] to 38.5%, based on voting rights and entered into an operating agreement, shareholders' agreement and loan agreement, in the form of a convertible debenture with Rad-icon. The convertible debenture bears interest at 5%, is secured by all of the assets of Rad-icon, excluding accounts receivable, and provides that DALSA will advance up to US$1,000,000 to Rad-icon during the period ending June 30, 2003. Under the terms of the shareholders' agreement, DALSA has the option to purchase all of the outstanding shares of Rad-icon at a price based on its revenues and profits in the year ending June 30, 2003. Rad-icon is engaged in the development of CMOS imagers for use in medical and non-destructive x-ray imaging. Since the Company exercises significant influence over Rad-icon, the investment is accounted for by the equity method.

## 9. Bank Credit Facilities and Long-Term Debt

The Company has borrowing facilities with its bank. An amount of $10,000,000 is available to fund operations subject to certain margin restrictions. Interest is at bank prime and amounts advanced are due on demand. In addition, an amount of $2,000,000 is available to finance capital expenditures. Repayments are due over a term of 60 months and interest is at prime plus 0.375% or at fixed rates as negotiated.

The Company also has bridge financing with its bank. An amount of US$15,000,000 is available under this facility, subject to review by the bank. The rate of interest varies from prime to prime plus 0.875% and is determined based on the Company's ratio of loan advances to its earnings before interest taxes, depreciation and amortization ["EBITDA"]. Once advanced, the principal portion will become payable in 19 quarterly installments of 1/28 of the principal amount, followed by a final quarterly installment equal to the remaining balance of the advance.

The Company has provided a floating charge on all assets as collateral for its credit facilities.

No amounts were outstanding under the credit facilities as at the current year-end [2000 - $5,323,000].

Long-term debt at December 31, 2001 is comprised of an interest-free loan to the Company in the amount of US$1,536,660 [see note 4]. This amount is to be paid annually over five years in equal amounts of US$300,000 for the first four years and US$336,660 in the final year. The Company has issued unconditional letters of credit for the loan in the amount of US$750,000 and conditional letters of credit in the amount of US$786,660.

Interest expense on long-term debt was $47,000 for the year ended December 31, 2001 and $493,000 for the year ended December 31, 2000.

## 10. Income Taxes

Investment tax credits are accrued when qualifying expenditures are made and there is reasonable assurance that the credits will be realized. Investment tax credits earned with respect to current expenditures for qualified research and development activities are included in the statement of operations as a reduction of expenses. Investment tax credits are subject to review by Canada Customs and Revenue Agency for the years 1997 to 2001.

The provision for income tax expense differs from the expense that would be obtained by applying Canadian statutory rates as a result of the following:

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| Basic rate applied to earnings before income taxes | **2,870** | (6,926) |
| Increase (decrease) in income taxes resulting from: | | |
| Amortization of intangible assets | **-** | 2,941 |
| Manufacturing and processing tax credit | **(776)** | (673) |
| Research and development superallowance | **(107)** | (102) |
| Expenses not deductible for tax purposes | **24** | 17 |
| Foreign tax differential | **152** | (53) |
| Other | **562** | (216) |
| **Total provision** | **2,725** | (5,012) |

For financial reporting purposes, earnings before income taxes includes the following components:

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| **Pre-tax earnings:** | | |
| Canada | **9,722** | 8,134 |
| Foreign | **(3,011)** | (24,243) |
| | **6,711** | (16,109) |

## 10. Income Taxes continued

Significant components of the provision for income taxes are as follows:

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| Current tax expense | **3,341** | 2,561 |
| Tax depreciation in excess of accounting depreciation | **(167)** | (20) |
| Non-deductible accounting reserves | **(289)** | (799) |
| Tax loss carryforwards | **(408)** | - |
| Intangible assets amortization in excess of tax deduction | **-** | (6,746) |
| Corporate financing fee | **162** | 220 |
| Research and development expenses deducted for tax purposes in excess of accounting | **86** | (228) |
| **Income tax (recovery) expense** | **2,725** | **(5,012)** |

Deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31 are:

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| **Deferred tax asset** | | |
| Tax depreciation in excess of accounting depreciation | **(71)** | (238) |
| Non-deductible accounting reserves | **1,337** | 1,048 |
| Corporate financing fees | **83** | 245 |
| Tax loss carryforwards | **408** | - |
| Research and development expenses deducted for tax purposes less than accounting | **240** | 326 |
| | **1,997** | 1,381 |

## 11. Share Capital

### Authorized

Unlimited common shares

Unlimited preferred shares, issuable in a series.

Preferred shares are non-voting, may be used in series with rights, privileges, restrictions and conditions thereon fixed by the Board of Directors of the Company at the time of issuance.

In May 2000, the Company initiated a two for one stock split. All share and per share information as presented in these financial statements has been restated to give retroactive effect to the share reorganization described above. All outstanding stock options were also amended to give effect to the stock split.

## 11. Share Capital continued

On October 16, 2000, the Company issued 1,000,000 Special Warrants at a price of $8.00 per Special Warrant. Each Special Warrant entitled the holder thereof to receive one unit [a "Unit"], consisting of one common share and one-half of one Purchase Warrant, without further payment. Each whole Purchase Warrant entitled the holder to purchase one common share at a price of $8.75 per share at any time prior to the earlier of: [i] two years from the date a receipt is issued by the Ontario Securities Commission for the final prospectus qualifying the distribution of the Units issuable upon exercise of the Special Warrants; and [ii] January 14, 2003. On November 6, 2000, the Board of Directors of the Company approved the filing with the Ontario Securities Commission ["OSC"] of a preliminary prospectus, qualifying the distribution of Units consisting of 1,000,000 common shares and 500,000 Purchase Warrants. The prospectus also qualifies the distribution of 50,000 compensation options issuable upon exercise of a non-assignable special broker's warrant granted to the agent in connection with the private placement of Special Warrants on October 16, 2000 as outlined above. These compensation options, which expire on October 16, 2002, provide for the issuance of one common share and one half Purchase Warrant for the payment of $8.00 per compensation option. On December 21, 2000, the Company received its receipt for the final prospectus from the OSC and the Special Warrants were converted to common shares and Purchase Warrants on January 2, 2001. At December 31, 2000, the Special Warrants were recorded at the gross proceeds of $8,000,000 less underwriting and issue expenses of $660,000, net of a deferred tax asset in the amount of $265,000.

| | Common shares | | Special Warrants | |
|---|---|---|---|---|
| | # | $ | # | $ |
| Balance, December 31, 1999 | **10,986,606** | **18,801** | | |
| Issued under previous employee stock option plan | **9,913** | **53** | | |
| Issued under employee stock purchase plan | **26,050** | **200** | | |
| Issued to directors as consideration for directors' fees | **4,456** | **32** | | |
| Issued pursuant to private placement | - | - | **1,000,000** | **7,605** |
| Balance, December 31, 2000 | **11,027,025** | **19,086** | **1,000,000** | **7,605** |
| Issued under previous employee stock option plan | **3,028** | **6** | | |
| Issued under employee stock purchase plan | **26,912** | **164** | | |
| Issued to directors as consideration for directors' fees | **7,284** | **60** | | |
| Issued pursuant to conversion of special warrants | **1,000,000** | **7,605** | **(1,000,000)** | **(7,605)** |
| **Balance, December 31, 2001** | **12,064,249** | **26,921** | - | - |

## 11. Share Capital continued

During 1996, the Company instituted an Employee Stock Option Plan ["Option Plan"]. At that time, the Company reserved 1,000,000 shares for issuance, pursuant to options granted under the Option Plan. On March 23, 2001, the shareholders of the Company approved an increase in the number of options available by 444,183 share options, making available for issue a total of 1,444,183 share options. Options may be granted at the discretion of the Board of Directors at an option price not less than the market value of the Company's common shares on the date of grant. The options vest over a period of three to five years and expire no later than the tenth anniversary of the date of grant. The purchase price of common shares under options outstanding at December 31, 2001, ranges from $6.00 to $9.00. At December 31, 2001, 284,094 of these options were exercisable. The weighted average remaining contractual life of those options is 2.87 years. The weighted average exercise price of options granted in the year ended December 31, 2001 and total outstanding options at December 31, 2001 was $6.80 and $7.07, respectively.

| Employee Stock Option Plan | Number of shares |
|---|---|
| **Balance, December 31, 1999** | **558,200** |
| Granted | **264,000** |
| Exercised | **(7,300)** |
| Cancelled | **(107,600)** |
| **Balance, December 31, 2000** | **707,300** |
| Granted | **267,750** |
| Exercised | **(750)** |
| Cancelled | **(95,700)** |
| **Balance, December 31, 2001** | **878,600** |

The following table summarizes information about stock options outstanding at December 31, 2001:

| Average exercise price $ | Number outstanding # | Weighted average contractual life [years] | Weighted average exercise price $ | Number exercisable # | Weighted average exercise price $ |
|---|---|---|---|---|---|
| 6.00-6.99 | 450,300 | 4.42 | 6.47 | 93,275 | 6.00 |
| 7.00-7.99 | 249,000 | 3.66 | 7.45 | 75,344 | 7.41 |
| 8.00-8.99 | 177,300 | 2.53 | 8.08 | 115,475 | 8.03 |
| 9.00-9.99 | 2,000 | 4.66 | 9.00 | 500 | 9.00 |
| | 878,600 | 3.82 | 7.07 | 284,594 | 7.20 |

## 11. Share Capital continued

Options granted under a previous stock plan for 2,278 common shares were outstanding as at December 31, 2000, at an exercise price of $0.765 per share. These options were exercised during 2001.

The Company has an Employee Stock Purchase Plan ["Purchase Plan"] pursuant to which employees and directors of the Company may be offered the opportunity to apply to the Company for a loan to purchase common shares of the Company. Under the Purchase Plan, the Company may issue the shares to employees who are not directors or principal shareholders, at a discount of up to 10% of the market value. Directors and principal shareholders may purchase shares at fair market value under the Purchase Plan. The Company has reserved 1,000,000 shares for issuance pursuant to the Purchase Plan. Loans bear interest at rates determined by the Company, are repayable monthly over a period no longer than ten years, are limited to one times annual salary or three times annual directors fees and are secured by the purchased shares. In practice, loans extended under the Purchase Plan do not exceed one year. To December 31, 2001, 109,264 shares have been issued under the Purchase Plan. Loans outstanding under the Purchase Plan at December 31, 2001, total $52,133 [$18,263 at December 31, 2000], are interest free, are repayable at dates on or before April 2002 and are included in accounts receivable. The loans are secured by Company common shares with a market value of $199,910 at December 31, 2001.

## 12. Research and Development

Research and development costs are presented net of related government funding and investment tax credits as follows:

| In thousands | **2001** **$** | 2000 $ |
|---|---|---|
| Total research and development expenditures | **13,625** | 13,212 |
| Government funding | **(56)** | (86) |
| Investment tax credits | **(1,443)** | (1,300) |
| **Net research and development expenditures** | **12,126** | 11,826 |

The Company is eligible for investment tax credits at a rate of 20% of qualifying scientific research and experimental development expenditures.

Funding of $2,832,000 has been received under the Defense Industry Productivity Program in prior years. The contribution is repayable, up to the amount received, at the rate of 2% of certain sales during the period January 1, 1996 to December 31, 2006. Repayments of $584,000 [$2,832,000 to December 31, 2001] have been charged to cost of products sold during the year ended December 31, 2001 [$510,000 - 2000].

## 13. Segmented Information

The Company designs, develops, manufacturers and markets image sensor and electronic camera products. The companies business units have been aggregated as they have similar economic and operating characteristics.

Revenues are attributed to countries based on the location of the customer and are distributed as follows:

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| Canada | **1,488** | 1,601 |
| USA | **36,618** | 34,123 |
| Europe, Middle East | **10,775** | 9,775 |
| Asia-Pacific | **7,554** | 7,822 |
| **Total revenue** | **56,435** | 53,321 |

The geographic distribution of identifiable assets is detailed below.

| In thousands | 2001 $ | 2000 $ |
|---|---|---|
| Canada | **31,906** | 34,664 |
| USA | **15,441** | 11,734 |
| **Identifiable assets** | **47,347** | 46,398 |

## 14. Comparative Figures

Certain of the comparative figures have been reclassified to conform with the presentation adopted in the current year.

## 15. Subsequent Events

On January 21, 2002, the Company entered into an agreement to purchase a controlling interest of the semiconductor foundry of Zarlink Semiconductor Inc., located in Bromont, Quebec. Included in this agreement is a multi-year arrangement in which the Company agrees to continue to supply to Zarlink Semiconductor certain products currently produced in this facility. The purchase price is estimated at $21.6 million in cash and other consideration for an 80.1% ownership interest in the Bromont foundry. The allocation of the purchase price is primarily acquired tangible assets.

On January 23, 2002, the Company signed a term sheet for the proposed purchase of the CCD Image Sensors Business of Royal Philips Electronics. The term sheet precludes either party from disclosing the financial details of the agreement until a definitive agreement has been reached.

On January 25, 2002, the Company entered into an agreement to sell 2,300,000 Special Warrants for gross proceeds of $23,000,000. Each Special Warrant will entitle the holder to acquire one common share without further consideration. The proceeds from the Offering will be escrowed on closing, for release to the Company upon the closing of the acquisition of the semiconductor foundry of Zarlink Semiconductor Inc. noted above. ■

# Notes

# Shareholder Information

## Annual Meeting of Shareholders - Wednesday, March 27, 2002

**Tours: 1:30 - 3:30pm**

Tours of the DALSA laboratories and facilities will be held for shareholders and friends of the Company. There will be an opportunity to see the laboratories and also to talk with members of the DALSA management. (visitors are welcome)

The **Annual Meeting of Shareholders** will be held at the offices of DALSA Corporation, 605 McMurray Road, Waterloo, Ontario, on Wednesday, March 27, 2002, 4:00pm (EST).

## Management Presentation

Immediately following the Annual Meeting of Shareholders there will be a management presentation with time for questions, answers, and discussion. Further, there will be an opportunity for shareholders and visitors to meet the rest of the executive management. We expect to finish by 6:00pm.

## Corporate Headquarters

605 McMurray Road
Waterloo, Ontario
Canada N2V 2E9
Tel: (519) 886-6000
Fax: (519) 886-0185
Website: www.dalsa.com

## Registrar and Transfer Agent

Computershare Trust Company of Canada, Toronto, Ontario

## Shareholder Contact

For change of address, shareholders are requested to write to Computershare Trust Company of Canada at:
100 University Avenue
9th Floor
Toronto, ON M5J 2Y1
Tel: 800-663-9097
416-981-9633
Fax: 416-981-9800

## Stock Listing

The Toronto Stock Exchange
Ticker Symbol: DSA

## Investor Relations Information

For investor information, please contact the Investor Relations Department at DALSA Corporation,
Tel: 519-886-6000, Fax: 519-886-0185; Email: investor@dalsa.com.

For Shareholders and others, please send us your email address if you wish to receive regular company information.

## 2002 Quarterly Earnings Release Dates and Annual Meeting of Shareholders

| | |
|---|---|
| Fourth Quarter 2001 and Year End | January 31, 2002 |
| Annual Meeting of Shareholders | March 27, 2002 |
| First Quarter | April 25, 2002 |
| Second Quarter | July 25, 2002 |
| Third Quarter | October 24, 2002 |
| Fourth Quarter | February 7, 2003 |

## Auditors

Ernst & Young LLP, Kitchener, Ontario

## Bankers

Bank of Montreal, Kitchener, Ontario

## Directors

Savvas G. Chamberlain, M.Sc., Ph.D., FIEEE
Chairman and Chief Executive Officer
DALSA Corporation

Graham A. Jullien, B.Tech, M.Sc., Ph.D., P.Eng.
iCORE Chair, Dept. of Electrical and Computer Engineering
University of Calgary

Donald L. Lenz, B.Sc.
Management Consultant

J. David Linton, B.A., LL.B.
Partner
White, Duncan, Ostner & Linton

Ian McPhee, B.Math, M.Math
Management Consultant

John H. Simons, B.Eng., M.Eng., MBA, P.Eng.
Management Consultant

Gene P. Weckler, BSEE, MSEE, D.Engr.
President
Rad-icon Imaging Corp.

## Officers

Savvas G. Chamberlain, M.Sc., Ph.D., FIEEE
Chairman, and Chief Executive Officer

Brian C. Doody, B.Sc., M.A.Sc., P.Eng.
President

Ralf M. Brooks, B.A.Sc., M.Sc., P.Eng.
Executive Vice President and
General Manager, Vision for Machines

Hugh F. Garvey, B.Sc.
Vice President and
General Manager, Life Sciences

Martin W. Hynd, B.Sc.
Vice President, Corporate Manufacturing

David J. Litwiller, H.B.A.Sc.
Vice President, Corporate Marketing

James W. Roberts, B.Sc., M.Math., Ph.D.
Vice President and
General Manager, Vision Systems

Peter M. Voss, B.Sc., B.A., CA
Vice President, Finance

## DALSA Around the World

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Fax: 719-599-7775

DALSA Life Sciences
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Suite 128
Tucson, AZ 85713
Tel: 520-791-7700
Fax: 520-791-7766

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Yoshiharu Hayakawa
Representative Director

### For more information

To learn more about DALSA Corporation, visit our site on the World Wide Web at www.dalsa.com

DALSA
technology with vision

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